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In the Supreme Court of the United States

OCTOBER TERM, 1977

No. 76-1137

ARTHUR FULMAN, Et Al, TRUSTEES,
PETITIONERS,

v.

UNITED STATES OF AMERICA,
RESPONDENT

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

BRIEF FOR THE PETITIONERS

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Opinions Below

The opinion of the United States District Court for the District of Massachusetts (App. B to Petition for Certiorari at 18) is reported at 407 F. Supp. 1039. The opinion of the U.S. Court of Appeals for the First Circuit (App. A to Petition for Certiorari at 8) is reported at 545 F.2d 268.

Jurisdiction

The judgment of the Court of Appeals for the First Circuit was entered on November 19, 1976. The petition for a writ of certiorari was filed on February 17, 1977, and was granted on May 23, 1977. This Court's jurisdiction is invoked under 28 U.S.C. section 1254(1).

Question Presented

Whether the dividends paid deduction allowable under section 561 of the Internal Revenue Code of 1954 should be measured by the fair market value of property distributed as a dividend in kind to individual stockholders, as Petitioners contend, or by the adjusted basis of such property to the distributing corporation, as Respondent contends.

Statutory Provisions Involved

Pursuant to Rule 40(1)(c), the text of the relevant portions of Title 26 U.S.C. are reproduced in the Appendix to this Brief.

Sec. 531 — Imposition of Accumulated Earnings Tax
Sec. 535 — Accumulated Taxable Income
Sec. 541 — Imposition of Personal Holding Company Tax
Sec. 545 — Undistributed Personal Holding Company Income
Sec. 547 — Deduction for Deficiency Dividends
Sec. 561 — Definition of Deduction for Dividends Paid
Sec. 562 — Rules Applicable in Determining Dividends Eligible for Dividends Paid Deduction
Sec. 301 — Distributions of Property
Sec. 312 — Effect on Earnings and Profits
Sec. 316 — Dividend Defined

Statement of the Case

This is a tax refund suit involving the application of sections 545, 547, 561 and 562 of Title 26 U.S.C., the Internal Revenue Code of 1954, as amended,[1] which provide for a reduction in the amount of undistributed personal holding company income subject to the personal holding company tax if the corporation makes certain dividend distributions to its shareholders.

Petitioners are the successors of the Pierce Investment Corp. (hereinafter referred to as "Taxpayer"), a Massachusetts corporation.

On November 1, 1966, the Internal Revenue Service determined that the Taxpayer had, for the years 1959, 1960, 1962, and 1963, been a personal holding company within the meaning of section 542(a) of the Internal Revenue Code. As a result, personal holding company taxes in the following amounts were assessed for the four years in question:

1959	$4,796.30
1960	8,374.00
1962	5,306.00
1963	8,095.00
Total	$26,571.30

On November 28, 1966, Taxpayer availed itself of the provisions of section 547 which permits a taxpayer to eliminate its liability for the personal holding company tax by declaring a dividend, termed a "deficiency dividend",

[1] Unless otherwise specified, citations to statutory provisions are to sections of the Internal Revenue Code of 1954, as amended (hereinafter the "Code"), codified in Title 26 of the United States Code.

at least equal to its prior years' undistributed personal holding company income. On that date, Taxpayer declared a deficiency dividend in the amount of $32,535, intending thereby to eliminate its liability. On December 31, 1966, Taxpayer satisfied its dividend declaration by distributing to each shareholder 55 shares of Schering Corporation stock and 10 shares of Gulf Oil Corporation stock. The fair market value of the stock distributed was $32,535, and its adjusted basis in the hands of the Taxpayer was $18,725.11.

Taxpayer timely filed a claim under section 547 of the Code for a dividends paid deduction of $32,535, the fair market value of the stock it had distributed. This claim was disallowed by the Internal Revenue Service to the extent that the amount claimed ($32,535) exceeded the Taxpayer's adjusted basis in the securities distributed ($18,725.11). As a result, the Internal Revenue Service, on April 18, 1969, assessed deficiencies in personal holding company tax for the calendar years 1962 and 1963 in the amounts of $2,960.21 and $8,095.00 respectively.

Taxpayer paid the assessed deficiencies, together with interest, in full, and timely filed a claim for refund of the tax paid. The Internal Revenue Service disallowed Taxpayer's claim for refund on June 3, 1971.

On April 10, 1973, Taxpayer instituted this action in the United States District Court for refund of the taxes paid. The case was decided on stipulated facts and cross motions for summary judgment. The District Court held in favor of the Government. On appeal, the First Circuit affirmed the District Court.

Introduction and Summary of Argument

Under our system of income taxation, which imposes potentially higher rates of tax on individuals than on corporations, an incentive exists for the individual to accumulate his income in a corporation, thereby shielding

part of his income from higher personal tax rates. The need to deter such actions has been recognized by Congress since 1913 and was specifically addressed in the enactment of both the accumulated earnings tax and the personal holding company tax.

The accumulated earnings tax, set forth in sections 531 through 537 of the Code, is imposed over and above the ordinary corporate income tax, upon the "accumulated taxable income" of any corporation which is found to have been utilized for the purpose of minimizing the income tax imposed on its shareholders by permitting its earnings to accumulate beyond the reasonable needs of its business. The personal holding company tax, set forth in sections 541 through 547 of the Code, is imposed on the "undistributed personal holding company income" of any corporation which meets the criteria, set forth in section 542, defining a personal holding company. A corporation will be classified as a personal holding company if, for a given tax year, more than 50% of its stock is owned, directly or constructively, by five or fewer individuals and if 60% or more of its adjusted gross income is derived from certain specified sources — such as interest, dividends, and other forms of passive investment income. The two taxes are mutually exclusive.

Because the number of stockholders in a corporation may vary, the sources of its income may change, and its reasonable business needs may fluctuate, corporations can, from year to year, slip in and out of the classifications mandating the application of either tax.

Since both the accumulated earnings tax and the personal holding company tax were designed to insure taxation at the shareholder level by inducing corporations to make dividend distributions, both statutory provisions relieve corporations of the tax altogether if they make such distributions in sufficient amounts. This is done by providing for

a "dividends paid deduction" in the calculation of accumulated taxable income (the base upon which the accumulated earnings tax is levied) in section 535(a), and in the calculation of undistributed personal holding company income (the base upon which the personal holding company tax is levied) in section 545(a). Section 562, which sets forth the rules for determining dividends eligible for the dividends paid deduction, states that:

> For purposes of this part, the term "dividend" shall, except as otherwise provided in this section, include only dividends described in section 316 (relating to definition of dividends for purposes of corporate distributions).

This case focuses upon the dividends paid deduction available to a corporation distributing property other than cash to an individual shareholder. The question presented is whether the dividends paid deduction should be equal to the fair market value of the property distributed or its adjusted basis in the hands of the distributing corporation.

The Government maintains that the appreciation or depreciation of property distributed, for purposes only of the dividends paid deduction, should be disregarded. It has adopted this position in Treas. Reg. §1.562-1(a) which states, in part, as follows:

> If a dividend is paid in property (other than money) the amount of the dividends paid deduction with respect to such property shall be the adjusted basis of the property in the hands of the distributing corporation at the time of distribution.

Petitioners submit that this regulation is invalid and that a corporation distributing a dividend in kind should instead receive a dividends paid deduction equal to the amount included in income by the shareholder-distributees

by virtue of such dividend. Petitioner adopts this position for the following reasons:

1. The purpose of both the personal holding company tax and the accumulated earnings tax is to insure taxation at the shareholder level by inducing corporations to make dividend distributions in sufficient amounts. The only principle of valuing dividends in kind for purposes of the dividends paid deduction which is consistent with this purpose is that the dividends paid deduction should equal the amount taxable to the recipient shareholder, as determined under Code sections 301 and 316.

2. An examination of the language and the legislative history of the Code provisions involved in this case reveals an intention on the part of Congress that reference be made to Code section 301, the section which governs taxation of dividends to shareholders, for the determination of the amount of the dividends paid deduction.

3. The use of fair market value to determine the dividends paid deduction is consistent with this Court's decision in the case of *Ivan Allen* v. *United States*, 422 U.S. 617 (1975), which held that for purposes of determining the applicability of the accumulated earnings tax, appreciated marketable securities would be taken into account at their fair market value. The Government's position adopted in Treas. Reg. §1.562-1(a) is inconsistent with that decision.

4. Treas. Reg. §1.562-1(a) leads to results which are inconsistent with the purpose underlying both the accumulated earnings tax and the personal holding company tax by permitting corporations to escape the full impact of these taxes without making distributions to the full extent intended by Congress.

Argument

I. Consistency With Statutory Purpose Requires That a Corporation Should Receive a Dividends Paid Deduction Equal to the Amount Included in Income by the Shareholder-Distributee.

An understanding of the Congress' purpose in enacting the accumulated earnings and personal holding company taxes is necessary to understand the rationale for Petitioners' position that a corporation distributing a dividend in kind should receive a dividends paid deduction equal to the amount included in income by the shareholder-distributee by virtue of such dividend. Both the personal holding company tax and the accumulated earnings tax were drafted to address a problem inherent in a tax system that taxes individuals at higher rates than it taxes corporations, i.e. both taxes were designed to deter taxpayers from insulating income from the graduated personal income tax by accumulating that income in a corporate entity. Neither tax was conceived of as a direct means of raising federal revenues. "The personal holding company surtax, like the surtax imposed by Section 102 [the predecessor of the accumulated earnings tax], was not intended to produce revenue *per se*. Instead, its primary purpose was to induce, or rather force, the distribution of the income of personal holding companies to their stockholders so that the latter would become liable to surtax on such income." Harry J. Rudick, "Section 102 and Personal Holding Company Provisions of the Internal Revenue Code," 49 Yale L.J. 171, 176 (1939); see B. Bittker and J. Eustice, *Federal Income Taxation of Corporations and Shareholders*, §8.01 at 8-3, and §8.20 at 8.35 (3d ed. 1971).

The historical evolution of these taxes demonstrates clearly that their purpose is to insure taxation at the shareholder level. In fact, both the personal holding company tax and the accumulated earnings tax stem from provisions in the very early versions of the Code which imposed a tax directly on a corporation's shareholders (based on their pro rata shares of corporate earnings) if the corporation was found to be improperly accumulating income. Tariff Act of 1913, ch. 16, Sec. II A(2), 38 Stat. 166. However, after this Court's decision in *Eisner* v. *Macomber*, 252 U.S. 189 (1920), doubts arose as to the constitutionality of such a tax when no dividend had been distributed by the corporation. Thus, in 1921, Congress removed the burden of the tax from the shareholder and placed it on the corporation. Revenue Act of 1921, ch. 136, Title II, sec. 220, 42 Stat. 247. However, the corporation could avoid the tax if the shareholders included the accumulated earnings of the corporation in their own taxable income.[2] "If the surtax is thus paid the failure to distribute the earnings has not resulted in any avoidance of tax and the reason for the imposition of the [accumulated earnings] tax on the corporation no longer exists." S. Rep. No. 52, 69th Cong., 1st Sess. 22 (1926); 1939-1 Cum. Bull. (Part 2) 332, 349.

Congressional intent to structure these taxes so as to compel distributions equal to the income realized by the corporation is further evidenced by the following passage from the Senate Finance Committee Report explaining the personal holding company tax provisions of the Revenue Act of 1934:

> Many will consider the surtax imposed on these personal holding companies a harsh measure. However, a corporation which falls within this section be-

[2] This provision was the forerunner of the present section 565 which establishes a deduction for "consent dividends".

cause of the nature of its business and the number of its stockholders can always escape this tax by distributing to its stockholders at least 90 percent [now 100 percent] of its adjusted net income. The stockholder will, of course, be subject to the graduated surtaxes upon such distributions. Thus, the section should work no real hardship upon any corporation except one which is used to reduce surtaxes upon its shareholders. S. Rep. No. 558, 73d Cong., 2d Sess. 15 (1934); 1939-1 CUM. BULL. (Part 2) 586, 597.

Because the purpose of these taxes is to deter taxpayers from using corporations to accumulate income, the statutory purpose is fully accomplished upon the distribution to shareholders of amounts which will result in taxable income to shareholders equal to accumulated taxable income or undistributed personal holding company income. This is underscored by the several escape provisions afforded to corporations which are affected by these taxes. For example, section 563 permits a corporation to declare a dividend within 2½ months after the close of a taxable year and to apply that dividend to the prior year for purposes of the dividends paid deduction. In addition, Section 565 provides a procedure for shareholders to treat as a dividend a specified amount which, although not actually distributed by the corporation, will qualify for the dividends paid deduction. Furthermore, in the case of a corporation which has been determined to be liable for a personal holding company tax well after the 2½ month period has expired, section 547 permits the corporation to declare a "deficiency dividend" in order to avoid the imposition of the tax. It was under this procedure that Petitioner made its distribution.

Congress envisioned a coherent, logical and internally consistent system for dealing with improper accumulations

of income by corporations. Once it is recognized that the purpose of these provisions is to insure taxation at the shareholder level, it follows that Congress intended that a corporation making dividend distributions would receive a dividends paid deduction determined by the amount included in the taxable income of the shareholder-distributees. This rule provides the necessary and sufficient inducement to make the desired distribution. A deduction of an amount less than fair market value would be unnecessary to fulfill the statutory purpose. A deduction of an amount greater than fair market value would permit a corporation to escape the full impact of the tax without making a distribution in the amount intended by Congress. Therefore, the valuation principle most consistent with the statutory purpose is that a corporation's dividends paid deduction should equal the amount included in the income of the shareholder-distributees.

Under that principle, a corporation distributing a dividend to an individual will receive a dividends paid deduction equal to the fair market value of the property distributed, because non-corporate shareholders must include the fair market value of distributions in kind in their taxable income. Code section 301(b)(1)(A), 301(c)(1). However, if the shareholder receiving the dividend is a corporation, the distributing corporation will receive a dividends paid deduction equal to the lesser of the fair market value or the adjusted basis of the property distributed, because that is the amount which will be included in the income of the corporate shareholder. Code section 301(b)(1)(B), 301(c)(1).

The First Circuit below thought it anomalous that the deduction for dividends paid would depend upon the character of the recipient, a result it assumed Congress could not have intended. Quite to the contrary, however, because the statutory purpose is clearly fulfilled if the amount of the

dividends paid deduction is equivalent to the amount includible in the income of the shareholder, it follows that the amount of the dividends paid deduction must differ in these two situations since the amount includible in the shareholder's income differs.[3]

That the dividends paid deduction should be the amount included in income by the shareholder-distributee is not "anomalous", but rather accords with the very careful structuring of Code sections 301-318 dealing with corporate distributions to shareholders.

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[3] The differentiation between corporate and non-corporate shareholders resulted from a deliberate decision to close a tax loophole available to corporations. This loophole, which was closed by the enactment of §301(b)(1)(B) in 1954, is well illustrated by an example in B. Bittker and J. Eustice, *supra*, ¶7.23:

> Assume that X (the distributing corporation) is wholly owned by A, another corporation. X, having earnings and profits of $100,000, distributes property to A with a value of $100,000 and an adjusted basis in its hands of $10,000. Were it not for section 301(b)(1)(B), A would have $100,000 of dividend income on receipt of the property; but, by virtue of the 85 percent deduction for intercorporate dividends provided by section 243 . . . , only $15,000 would be subject to tax. Thus, at trivial tax cost A could obtain a $100,000 stepped-up basis for computing depreciation and gain or loss on the distributed property. The "lower of value or basis" rule of section 301(b)(1)(B) avoids this result, with its attendant posibilities for manipulation, by providing that the "amount" of the distribution to A is only $10,000, the property's adjusted basis to X; similarly, section 301(d)(2) provides that A's basis for the property will be $10,000, its basis in the hands of X. If X was required to recognize $5,000 of gain on the distribution (e.g., because of section 1245), then the "amount" of A's section 301 distribution, and its basis for the distributed property, would be increased by the recognized gain to $15,000. (Footnotes omitted.)

The provisions of section 301(b)(1)(B) were thus drafted to remedy a tax abuse which stemmed from the tax treatment of intercorporate distributions. But for the existence of the dividends-received deduction available to corporate distributees, a distribution of property to a corporate stockholder would be valued at its fair market value.

II. Statutory History As Well As the Language of the Relevant Statutory Provisions Indicate That Congress Intended the Valuation Principles of Section 301 To Be Incorporated Into Section 316 and That the Dividends Paid Deduction Should Equal the Amount Included In Income By the Shareholder-Distributees.

The language of the relevant provisions of the Code, viewed in the light of their legislative history and statutory purposes, requires that the amount of the deduction for dividends paid under section 562 be equal to the amount includible in the income of shareholders as a dividend under section 301. In the cases of *H. Wetter Mfg. Co.* v. *United States*, 458 F.2d 1033 (6th Cir. 1972) and *Gulf Inland Corp.* v. *United States*, 75-2 USTC ¶9620 (W.D. La. 1975) (appeal docketed No. 75-3767, 5th Cir., Oct. 14, 1975), the courts found that the statutory language mandated this result and that Treas. Reg. §1.562-1(a) is invalid.

The First Circuit, however, failed to see that section 301 provides the rule for measuring the amount of a distribution under section 316 and thus under section 562. Petitioners believe that this oversight stemmed from the fact that the Court's attention was not drawn to the successive drafts of the bill which was enacted as the 1954 Code.

The statutory interrelationships among sections 562, 316 and 301 which were designed by Congress can best be understood by examining the pertinent provisions of H.R. 8300 83d Cong. 2d Sess. (1954) as it was introduced in the House of Representatives. Section 562(a) of that bill, provided, as (with the exception of a clerical amendment) does section 562(a) of the Code as enacted:

> For purposes of this part, the term "dividend" shall, except as otherwise provided in this section,

include only dividends described in section 312 (relating to definition of dividends for purposes of corporate distributions).

Section 312 of the House draft, which was referred to in the passage quoted above, contained the definition of the term "dividend," and is similar to section 316 of the Code as finally enacted. The pertinent part of that section stated as follows:

SECTION 312. DEFINITIONS RELATING TO CORPORATE DISTRIBUTIONS.

(a) DIVIDENDS

(1) GENERAL RULE. — The term "dividend" when used in this subtitle means *a distribution (as determined in section* 301(a)) of property by a corporation to its shareholders, which is —

(A) out of earnings and profits accumulated after February 28, 1913, or

(B) out of the earnings and profits of the taxable year .... (Emphasis supplied.)

The valuation rules of section 301(a) of the bill were thus specifically incorporated into the definition of dividend in section 312. Accordingly, we turn to section 301(a) of the House draft, which read:

SECTION 301. CORPORATE DISTRIBUTIONS OF SECURITIES AND PROPERTY — EFFECT ON SHAREHOLDER.

(a) IN GENERAL. — A distribution of securities or property by a corporation to a shareholder, other than in partial or complete liquidation as defined in section 336, shall be taxable to the extent provided in subsection (b), subject to the provisions of section 302 (relating to redemption of stock) and section 306 (relating to distributions of securities and property). *For this purpose, a "distribution" shall be considered to be the amount of money, and the fair market value of securities and property received, except that if the shareholder is a corporation receiving property the adjusted basis of which in the hands of the distributing corporation is less than its fair market value, the distribution shall be considered to be an amount not greater than such adjusted basis in the hands of the distributing corporation* increased in the amount of gain recognized to the distributing corporation by reason of such distribution. The amount of any such distribution shall be reduced by the amount of any indebtedness to which it is subject. (Emphasis supplied.)

Under the House drafts of section 301(a), section 312 and section 562, it is clear that a corporation distributing property (other than money) to a shareholder as a dividend would receive a deduction for dividends paid equal to the amount included as dividend income by the shareholder-distributee. If the shareholder were not a corporation, the deduction would equal the fair market value of the property distributed. If, on the other hand, the distribution were made to a corporate shareholder, the dividends paid deduction would equal the lesser of the adjusted basis or the fair market value of the property distributed.

To summarize, the language of the House draft of section 562(a) provided that one should look to section 312 of the draft to find the definition of dividends eligible for the dividends paid deduction. Section 312(a)(1) defined the term dividends as "a distribution (as determined in 301(a)" out of current or accumulated earnings and profits.

Section 301(a) then determined that "a 'distribution' shall be considered to be the amount of money, and the fair market value of securities received, except that if the shareholder is a corporation receiving property" the distribution shall be the lower of adjusted basis or fair market value.

In its consideration of the House draft of the bill, the Senate Finance Committee reorganized and reworded several sections. In the course of these revisions, section 312 in the House draft became section 316 of the present Code, the parenthetical reference in the House draft to 301(a) was dropped, and section 301(a) of the House draft was subdivided so that its provisions are now found in sections 301(a) and 301(b). These changes, however, were merely organizational and stylistic. In addition, the Senate also made some substantive changes to the House draft of the bill, but it was careful to mention those changes in the committee report explaining its draft. With respect to section 316, the Committee noted:

> [Y]our Committee has not adopted a rule which appeared in section 312(a) of the House bill, incorporating the principle of *Dixie Pine Products* v. *Commissioner*, (320 U.S. 516). This rule relates to the effect on earnings and profits where the liability for Federal income taxes is the subject of a bona fide contest by a taxpayer using the accrual method of accounting. S. Rep. No. 1622, 83d Cong., 2d Sess. 251-52; 3 U.S. Code Cong. & Adm. News 4621, 4889 (1954).

Thus, a substantive change was made to section 312 of the House draft (in an area which does not affect the outcome of this case), and this amendment was clearly explained in the Committee Report. With the exception of the abandonment of the rule of *Dixie Pine Products*, the Senate Finance Committee stated that section 316 of its draft "corresponds generally . . . to section 312(a) of the House bill." S. Rep. No. 1622, 83d Cong., 2d Sess. 251; U.S. Code Cong. & Adm. News, 4621, 4889 (1954).

Evidently, the Senate's elimination of the parenthetical reference to section 301(a) was considered to be merely a stylistic change. It was not considered to be substantive, for no mention of it was made in the Committee Report.

Apparently, the parenthetical reference was thought to be unnecessary because the words of the sections themselves incorporate the cross-reference. Section 316(a) of the Code states that "the term 'dividend' means *any distribution* of property made by a corporation to its shareholders", limited in amount by current and accumulated earnings and profits. Section 301(b)(1) (previously part of 301(a) of the House draft) specifically provides that "*the amount of any distribution* shall be —

> (A) Noncorporate Distributees — If the shareholder is not a corporation, the amount of money received, plus the fair market value of the other property received.
>
> (B) Corporate Distributees — If a shareholder is a corporation, unless subparagraph (D) applies, the amount of money received, plus whichever of the following is the lesser:
>
> (i) the fair market value of the other property received; or
>
> (ii) the adjusted basis (in the hands of the distributing corporation immediately before the distribution) of the other property received, increased in the amount of gain to the distributing corporation which is recognized under subsection (b), (c), or (d) of section 311, under section 341(f), or under section 617(d)(1), 1245(a), 1250(a), 1251(c), 1252(a), or 1254(a). (Emphasis supplied.)

Furthermore, section 301(c)(1) states as follows:

> (c) AMOUNT TAXABLE.—In the case of a distribution to which subsection (a) applies —
>
> (1) AMOUNT CONSTITUTING DIVIDEND. — That portion of the distribution which is a dividend (as defined in section 316) shall be included in gross income.

Clearly, then, section 316 was not intended to be read in isolation. Standing alone it provides no rule of valuation. It merely limits the amount of a distribution which can be a dividend. To determine the amount of the distribution, one must turn to section 301 of the Code. This scheme of statutory interrelationships is both clear both from the statutory history and from the words of the statute itself, and require, as Congress intended, that the dividends paid deduction be equal to the amount included in income by the shareholder-distributee.

III. CONSISTENCY WITH THIS COURT'S DECISION IN *Ivan Allen Co.* v. *United States* REQUIRES THAT PROPERTY DISTRIBUTED AS A DIVIDEND SHOULD BE VALUED AT FAIR MARKET VALUE FOR PURPOSES OF THE DIVIDENDS PAID DEDUCTION.

The proper computation of the dividends paid deduction is, as indicated above, pertinent to provisions of the Internal Revenue Code other than the personal holding company tax. The dividends paid deduction is also important in the calculation of accumulated taxable income (section 535(a)) for purposes of the accumulated earnings tax.[4]

[4] The calculation of the dividends paid deduction is also applicable to the provisions governing the calculation of undistributed foreign personal holding company income [section 556] as well as the provisions governing regulated investment companies and real estate investment trusts (sections 852(b), 857(b)).

In enacting these provisions, Congress aimed at the elimination of the same basic problem — the postponement of taxation of income at the progressive rate structure applicable to individuals by accumulation of income in a corporation. In the furtherance of this objective, Congress imposed a tax, in addition to the normal corporate income tax, if the criteria for liability under each respective section are satisfied.

Both the personal holding company tax and the accumulated earnings tax follow the same pattern in their application. Once the applicability of a particular tax has been determined, the current year's taxable income is adjusted to determine the amount subject to the tax. The adjustments prescribed are made primarily for the purpose of deriving an amount that more accurately reflects the corporation's net economic gain than does taxable income, and thus corresponds more closely to economic reality. See B. Bittker & J. Eustice, *supra*, §§8.09, 8.25. Thus, for example, the corporation's taxable income is reduced by federal taxes for the year and is increased by the 85 percent dividends received deduction permitted by section 243. Most relevant here is the deduction from taxable income of dividends paid by the corporation as defined in section 561, in order to arrive at the income subject to the additional tax.

In the case of *Ivan Allen* v. *United States*, 422 U.S. 617 (1975), this Court accepted the Government's position that in determining a corporation's liability for the accumulated earnings tax, the inquiry must focus on the corporation's true economic condition rather than on its balance sheet. More specifically, this Court held that in determining whether a corporation had accumulated earnings beyond the reasonably anticipated needs of its business, appreciated marketable securities should be valued at fair market value rather than at cost. The Court found that the tax is directed at economic reality. "Cost of the marketable securi-

ties on the assets side of the corporation's balance sheet would appear to be largely an irrelevant gauge of the taxpayer's true financial condition. Certainly, a lender would not evaluate a potential borrower's marketable securities at cost. Realistic financial condition is the focus of the lender's inquiry. It also must be the focus of the Commissioner's inquiry in determining the applicability of the accumulated earnings tax." 422 U.S. at 629-30 (footnote omitted).

The Court reached this conclusion by examining the structure of the accumulated earnings tax to determine its focus.

> The adjustments [made to taxable income before applying the tax] consist of the various items described in §535(b), including federal income tax, the deduction for dividends paid, defined in §561, and the accumulated earnigs credit defined in §535(c). The adjustments prescribed by §§535(a) and (b) are designed generally to assure that a corporation's "accumulated taxable income" reflects more accurately than "taxable income" the amount actually available to the corporation for business purposes. This explains the deductions for dividends paid and for federal income taxes; neither of these enters into the computation of taxable income ....
>
> The purport of the accumulated earnings tax structure established by §§531-537, therefore, is to determine the corporation's true economic condition before its liability for tax upon "accumulated taxable income" is determined. 422 U.S. at 626-27.

Thus, the purpose of the several adjustments made to taxable income before application of the additional taxes

is to arrive at a true reflection of the corporation's financial condition. "Obviously," the Court stated, "dividends paid and federal income taxes deplete corporate resources and must be recognized if the corporation's economic condition is to be properly perceived." 422 U.S. at 626.

The Court's analysis is equally applicable to the personal holding company tax, which follows the same basic structure in its application as the accumulated earnings tax. The logical consequence of this analysis is that the amount of a dividend paid in the form of securities should be measured by their fair market value. If, as the Government contends, the deduction allowed for dividends paid were to be calculated at the adjusted basis of property distributed as a dividend, this purpose would be thwarted. The property distributed could have risen steeply or fallen drastically in value since it was purchased. The cost of such property is simply an historical entry on the balance sheet, and bears little relation to the real financial condition of the corporation.[5]

Just as appreciated marketable securities are available for use in meeting the needs of the business to the extent of their fair market value, similarly, the assets of the corporation are depleted to the extent of fair market value when those securities are distributed. If, as was decided by this Court, a corporation's dividend paying capacity is to be measured by valuing its appreciated securities at fair market value, then the dividends actually paid must be measured in accordance with the same standards.

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[5] *See* Brief for the United States at 8, *Ivan Allen Co.* v. *United States*, 422 U.S. 617 (1975).

IV. Treasury Regulation Section 1.562-1(a), insofar as It Pertains to Valuation of Dividends Paid in Property, Is Invalid Because It Is Arbitrary and Leads to Results Which Are Inconsistent with the Statutory Purpose.

A. *The Regulation Is Arbitrary*

In promulgating a regulation, the Treasury Department is constrained by the principle that its interpretation of the Code must be reasonable and consistent with the will of Congress. An interpretive regulation cannot be arbitrary; it must derive from some manifestation of Congressional intent.

The First Circuit below, despite the holding of the Sixth Circuit in *Wetter*, concluded that the Code itself does not answer the question of how to determine the extent to which a dividend in kind may be used for the dividends paid deduction. Thus, the Court looked to external aids in interpreting the intent of Congress and in justifying Treas. Reg. §1.562-1(a). However, upon examining the principal bases of the Court's decision, it is clear that the foundations upon which it has constructed its rationale will not support the regulation. In fact, the regulation is the result of an arbitrary extension of administrative authority.

1. *Section 27(d) of the Code of 1939 does not support the Regulation.*

In upholding the Regulation, the First Circuit relied upon a statement in the Report of the Senate Finance Committee accompanying the draft of the bill which became the 1954 Code. The portion of the Senate Report relied upon is the following:

> *Section 562. Rules Applicable in Determining Dividends Eligible for Dividends Paid Deduction.*
>
> This section conforms to section 562 of the House bill except for a clerical amendment.
>
> Subsection (a) provides that the term "dividend" for purposes of this part shall include, except as otherwise provided in this section, only those dividends described in section 316 (relating to definition of dividends for purposes of corporate distributions). The requirement of sections 27 (d), (e), (f), and (i) of existing law are contained in the definition of "dividend" in section 312,[6] and accordingly are not restated in section 562. S. Rep. No. 1622, 83d Cong., 2d Sess. 325; U.S. Code Cong. & Adm. News 4621, 4965-66 (1954).

The Court asserted that this statement indicates that Congress did not contemplate the abrogation of the rule of old section 27(d), and that the regulation should be upheld because it "substantially reflects" that rule. 545 F.2d at 270; Appendix A to Petition for Certiorari at 11.

Section 27(d) of the 1939 Code, to which the Senate Committee refers, provided a different rule for determining the amount of the dividends paid deduction under the 1939 Code. That section provided:

> (d) Dividends in Kind.—If a dividend is paid in property other than money (including stock of the corporation if held by the corporation as an investment) the amount with respect thereto which shall be used in computing the basic surtax credit shall be the

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[6] The reference here to "section 312" is obviously a typographical error and is intended to be a reference to "section 316". *See* decision of the U.S. District Court in this case at its footnote 5 (Appendix B to Petition for Certiorari at 22).

> adjusted basis of the property in the hands of the corporation at the time of the payment, or the fair market value of the property at the time of the payment, whichever is the lower.[7]

We respectfully submit that the Court's conclusion is erroneous on at least two grounds.

First, with respect to the Committee Report, Petitioners maintain that Congress did not there indicate its intent to perpetuate the old valuation principle of the 1939 Code. Rather, it is submitted that Congress simply intended to indicate that the matters previously addressed in section 27 (which dealt only with the special taxes now grouped in subchapter G), would now be dealt with consistently throughout the Code and could therefore be encompassed by section 316 and its related provisions. We submit that this is the only logical interpretation of the reference to sections 27(d), (e), (f) and (i) in the Committee Reports. The rule of 27(d) is simply not contained in section 316; in fact, neither are the provisions of section 27(e) (dividends in obligations of the corporation), section 27(f) (taxable stock dividends) or section 27(i) (nontaxable distributions). Since it is clear that Congress did not in fact incorporate the rules of Sections 27(d), (e), (f) and (i) of the 1939 Code into section 316, Petitioners' interpretation is the only reasonable one.

Second, it is clear that Treas. Reg. § 1.562-1(a) does not substantially reflect the rule of old section 27(d). That statute provided that where a dividend is paid in property other than money, the amount to be used in computing the "basic surtax credit" would be the adjusted basis of the property *or* its fair market value, *whichever is the lower.*

[7] The "basic surtax credit" to which section 27(d) referred was comparable to the "deduction for dividends paid" in section 561 of the present Code.

The regulation, however, provides simply that such a dividend in kind will be measured, for purposes of the dividends paid deduction, only by the adjusted basis of the property, without regard to its fair market value.

These two rules will produce different results every time that a corporation distributes depreciated property for purposes of the dividends paid deduction. Under Treas. Reg. §1.562-1(a), if depreciated property is distributed as a dividend, the dividends paid deduction would equal the adjusted basis of such property. In contrast, the rule of section 27(d) would require that the fair market value, which is lower than the basis, be used to determine the deduction.

In summary, it is submitted that Congress did not intend to perpetuate the old valuation rule of the 1939 Code. Furthermore, it is clear that the regulation in question does not reflect that rule. Thus, section 27(d) cannot be used to support the regulation.

2. *Code section 312 cannot support Regulation §1.562-1(a) because it is irrelevant to the subject matter of that Regulation.*

In upholding the validity of the Regulation, the First Circuit also accepted the argument that section 312 of the Code is most relevant in determining the amount of the dividends paid deduction when property has been distributed.[8] This argument, however, is fallacious, for sec-

[8] The portion of section 312 which is relied upon reads as follows:

> SEC. 312. EFFECT ON EARNINGS AND PROFITS.
>
> (a) GENERAL RULE—Except as otherwise provided in this section, on the distribution of property by a corporation with respect to its stock, the earnings and profits of the corporation (to the extent thereof) shall be decreased by the sum of
>
> (1) the amount of money,
>
> (2) the principal amount of the obligations of such corporation, and
>
> (3) the adjusted basis of the other property,
>
> so distributed.

tion 312 has no bearing whatsoever upon taxation at the corporate level.

Section 312 merely deals with the bookkeeping adjustment which is made to the earnings and profits account of a corporation when it distributes property to shareholders. It sets forth the procedure for adjusting that account which limits the amount of a distribution which may be treated as a dividend. Section 316 states that, as a general rule, a distribution to which section 301 applies can only be a dividend to the extent that it is out of corporate earnings and profits. Thus, if the earnings and profits account is not large enough to cover the distribution, only a part of the distribution will be a dividend, and taxable as ordinary income under section 301(c)(1). Section 312 has no relevance at all to the question of whether a distribution is a taxable event at the corporate level; in fact, section 312 does not govern the determination of whether a distribution is a taxable event at any level — whether corporate or individual. Instead, section 311 governs this question at the corporate level, and section 301 governs this question at the shareholder level. The only relevance then of section 312 is to the question of how a particular corporate distribution is to be taxed to a shareholder under section 301(c), i.e. whether he must treat it as a dividend, a reduction of basis, or capital gain.

The opinion of the First Circuit is based on the erroneous assumption that the definition of the term "dividend" varies with its context. On the contrary the concept of a "dividend" is unitary and consistent. "Dividend" is a term of art which does not take on different meanings if its reference changes from corporations to shareholders. A dividend (section 316) is a distribution (section 301) out of earnings and profits (section 312). That is a unitary definition, of which section 312 is but a part. Its

meaning is intended to be consistent whether in the context of shareholder taxation or corporate taxation.

In summary, Treas. Reg. § 1.562-1(a) is not authorized either by any provisions of the Code, or by any of the legislative history surrounding the drafting of the Code. Furthermore, no statutory support for this regulation under prior revenue acts can be found. The regulation is the result of an arbitrary exercise of administrative regulation-making power.[9]

B. *The Regulation Leads to Results Which Are Inconsistent with the Purpose of the Statute.*

As indicated above, the purpose of both the personal holding company tax and the accumulated earnings tax is to insure taxation at the shareholder level by inducing corporations to make distributions of their after-tax income to shareholders. Individual shareholders must then include in their income the cash received as well as property received to the extent of its fair market value.

In light of the statutory purpose, it is easily demonstrated that the rule advanced by the Government leads to inconsistent and irrational results. The Commissioner's regulation creates a loophole for corporations and their stockholders, permitting them to escape the full impact of these taxes. For, if the amount of the dividends paid deduction is equal to the adjusted basis of the property distribu-

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[9] Several commentators have questioned the regulation. *See* Montgomery's FEDERAL TAXES, at 20.97 (39th ed. 1964). Another commentator, writing subsequent to the *Wetter* decision, also concluded that the regulation produced an improper result. *See* Nicholson, 114-2nd T.M., *Personal Holding Companies (Domestic) —Taxation and Relief*, at A8 and A9. *See also*, Rabkin & Johnson, FEDERAL INCOME, GIFT AND ESTATE TAXATION, Sec. 17.11 at 1765-66 (1977); Broenen & Preston, *Undistributed PHC Income: The Sixth Circuit in H. Wetter Mfg. Co. is Historically Sound*, 2 J. CORP. TAXATION 69 (1975).

ted, a corporation which holds depreciated property could distribute it as a dividend and claim the higher adjusted basis for its deduction, while the shareholders would be taxed only to the extent of the property's lower fair market value. In this manner, a tax on less than the amount of the personal holding company income would be levied on the individual stockholders. This is precisely the result that would be occasioned by Treas. Reg. § 1.562-1(a), and it is a result which is wholly inconsistent with the Congressional purpose in enacting the accumulated earnings tax and the personal holding company tax.

This inconsistency can be well illustrated by an example. If a personal holding company with undistributed personal holding company income of $100,000 were to distribute securities with a basis of $100,000 and a fair market value of $50,000, the individual shareholders would include in their income only $50,000, the fair market value of the securities at the time of distribution, while the corporation would be allowed a dividends paid deduction of $100,000, the adjusted basis of the securities in its hands. Thus, the corporation would be able to avoid the personal holding company tax entirely under the Commissioner's regulation even though the shareholders would not pay tax on the full amount of the corporation's undistributed personal holding company income. The regulation thus creates a loophole which is totally at odds with the purpose of the tax and could seriously undermine its effectiveness.

This anomalous result was avoided by the courts in several cases which interpreted the personal holding company tax as it existed in 1934. As it affects this discussion, that version of the personal holding company tax was no different from the way it appears today. In the case of *General Securities Co.* v. *Commissioner*, 42 B.T.A. 754 (1940), *aff'd* 123 F.2d 192 (10th Cir. 1941), the taxpayer, a personal holding company, distributed to its shareholders

depreciated property having a fair market value of $1,068.33 and a basis of $110,564.64. The taxpayer claimed a dividends paid deduction equal to the basis of the property distributed. The Board of Tax Appeals, in a decision which was affirmed by the Tenth Circuit, held that:

> We think that the Congressional reports from which we have quoted show that it was the intent of Congress that a personal holding company coming within the provisions of the act should receive a deduction against its "adjusted net income" for "dividends paid" of an amount equal to the amount of such dividends taxable to the stockholders. If this were not true, petitioner would receive a deduction for dividends paid of $103,898.17, which would be taxable to the stockholders only to the extent of $1,068.33. This result, we think, would be contrary to the intent of Congress. 42 B.T.A. at 758.

Accord, Foley Securities Co. v. *Commissioner*, 38 B.T.A. 1036 (1938), *aff'd*, 106 F.2d 731 (8th Cir. 1939).

The courts deciding *General Securities*, in holding that the proper valuation of an in-kind dividend for the purposes of the dividends paid deduction is the fair market value of the property, recognized that the purpose and structure of the personal holding company tax required that the amount of the deduction equal the amount taxable to the shareholders. Congress likewise recognized and carried out this purpose in the statutory provisions which were enacted as part of the 1954 Code.

In *General Securities*, the taxpayer urged the rule adopted by the Government in Treas. Reg. §1.562-1(a). This rule was rejected by the courts. Petitioners submit that this rule should be rejected again.

Conclusion

For the reasons stated above, Petitioners respectfully submit that the judgment of the Court below should be reversed.

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APPENDIX

Statutory Provisions Involved

INTERNAL REVENUE CODE OF 1954, AS AMENDED, UNITED STATES CODE, TITLE 26

Sec. 531. Imposition of Accumulated Earnings Tax.

In addition to other taxes imposed by this chapter, there is hereby imposed for each taxable year on the accumulated taxable income (as defined in section 535) of every corporation described in section 532, an accumulated earnings tax equal to the sum of—

(1) 27½ percent of the accumulated taxable income not in excess of $100,000, plus

(2) 38½ percent of the accumulated taxable income in excess of $100,000.

Sec. 535. Accumulated Taxable Income.

(a) DEFINITION.—For purposes of this subtitle, the term "accumulated taxable income" means the taxable income, adjusted in the manner provided in subsection (b), minus the sum of the dividends paid deduction (as defined in section 561) and the accumulated earnings credit (as defined in subsection (c)).

• • • •

(c) ACCUMULATED EARNINGS CREDIT.—

(1) GENERAL RULE.—For purposes of subsection (a), in the case of a corporation other than a mere holding or investment company the accumulated earnings credit is (A) an amount equal to such part of the earnings and profits for the taxable year as are retained for the reasonable needs of the business, minus (B) the deduction allowed by subsection (b)(6). For purposes of this paragraph, the

amount of the earnings and profits for the taxable year which are retained is the amount by which the earnings and profits for the taxable year exceed the dividends paid deduction (as defined in section 561) for such year.

• • • •

Sec. 541. Imposition of Personal Holding Company Tax.

In addition to other taxes imposed by this chapter, there is hereby imposed for each taxable year on the undistributed personal holding company income (as defined in section 545) of every personal holding company (as defined in section 542) a personal holding company tax equal to 70 percent of the undistributed personal holding company income.

Sec. 545. Undistributed Personal Holding Company Income.

(a) DEFINITION.—For purposes of this part, the term "undistributed personal holding company income", means the taxable income of a personal holding company adjusted in the manner provided in subsections (b), (c), and (d), minus the dividends paid deduction as defined in section 561. In the case of a personal holding company which is a foreign corporation, not more than 10 percent in value of the outstanding stock of which is owned (within the meaning of section 958(a)) during the last half of the taxable year by United States persons, the term "undistributed personal holding company income" means the amount determined by multiplying the undistributed personal holding company income (determined without regard to this sentence) by the percentage in value of its outstanding stock which is the greatest percentage in value of its outstanding stock so owned by United States persons on any one day during such period.

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Sec. 547. Deduction for Deficiency Dividends.

(a) GENERAL RULE.—If a determination (as defined in subsection (c)) with respect to a taxpayer establishes liability for personal holding company tax imposed by section 541 (or by a corresponding provision of a prior income tax law) for any taxable year, a deduction shall be allowed to the taxpayer for the amount of deficiency dividends (as defined in subsection (d)) for the purpose of determining the personal holding company tax for such year, but not for the purpose of determining interest, additional amounts, or assessable penalties computed with respect to such personal holding company tax.

• • • •

(d) DEFICIENCY DIVIDENDS.—

(1) DEFINITION.—For purposes of this section, the term "deficiency dividends" means the amount of the dividends paid by the corporation on or after the date of the determination and before filing claim under subsection (e), which would have been includible in the computation of the deduction for dividends paid under section 561 for the taxable year with respect to which the liability for personal holding company tax exists, if distributed during such taxable year. No dividends shall be considered as deficiency dividends for purposes of subsection (a) unless distributed within 90 days after the determination.

(2) EFFECT ON DIVIDENDS PAID DEDUCTION.—

(A) FOR TAXABLE YEAR IN WHICH PAID.—Deficiency dividends paid in any taxable year (to the extent of the portion thereof taken into account under subsection (a) in determining personal holding company tax) shall not be included in the amount of dividends paid for such year for purposes of computing the dividends paid deduction for such year and succeeding years.

(B) FOR PRIOR TAXABLE YEAR.—Deficiency dividends paid in any taxable year (to the extent of the portion thereof taken into account under subsection (a) in determining personal holding company tax) shall not be allowed for purposes of section 563(b) in the computation of the dividends paid deduction for the taxable year preceding the taxable year in which paid.

• • • •

Sec. 561. Definition of Deduction for Dividends Paid.

(a) GENERAL RULE.—The deduction for dividends paid shall be the sum of—

(1) the dividends paid during the taxable year,

(2) the consent dividends for the taxable year (determined under section 565), and

(3) in the case of a personal holding company, the dividend carryover described in section 564.

(b) SPECIAL RULES APPLICABLE.—In determining the deduction for dividends paid, the rules provided in section 562 (relating to rules applicable in determining dividends eligible for dividends paid deduction) and section 563 (relating to dividends paid after the close of the taxable year) shall be applicable.

Sec. 562. Rules Applicable in Determining Dividends Eligible for Dividends Paid Deduction.

(a) GENERAL RULE.—For purposes of this part, the term "dividend" shall, except as otherwise provided in this section, include only dividends described in section 316 (relating to definition of dividends for purposes of corporate distributions).

• • • •

Sec. 301. Distributions of Property.

(a) IN GENERAL.—Except as otherwise provided in this chapter, a distribution of property (as defined in section 317(a)) made by a corporation to a shareholder with respect to its stock shall be treated in the manner provided in subsection (c).

(b) AMOUNT DISTRIBUTED.—

(1) GENERAL RULE.—For purposes of this section, the amount of any distribution shall be—

(A) NONCORPORATE DISTRIBUTEES.—If the shareholder is not a corporation, the amount of money received, plus the fair market value of the other property received.

(B) CORPORATE DISTRIBUTEES.—If the shareholder is a corporation, unless subparagraph (D) applies, the amount of money received, plus whichever of the following is the lesser:

(i) the fair market value of the other property received; or

(ii) the adjusted basis (in the hands of the distributing corporation immediately before the distribution) of the other property received, increased in the amount of gain to the distributing corporation which is recognized under subsection (b), (c), or (d) of section 311, under section 341(f), or under section 617(d)(1), 1245(a), 1250(a), 1251(c), 1252(a), or 1254(a).

• • • •

(3) DETERMINATION OF FAIR MARKET VALUE.—For purposes of this section, fair market value shall be determined as of the date of the distribution.

(c) AMOUNT TAXABLE.—In the case of a distribution to which subsection (a) applies—

(1) AMOUNT CONSTITUTING DIVIDEND.—That portion of the distribution which is a dividend (as defined in section 316) shall be included in gross income.

(2) AMOUNT APPLIED AGAINST BASIS.—That portion of the distribution which is not a dividend shall be applied against and reduce the adjusted basis of the stock.

(3) AMOUNT IN EXCESS OF BASIS.—

(A) IN GENERAL.—Except as provided in subparagraph (B), that portion of the distribution which is not a dividend, to the extent that it exceeds the adjusted basis of the stock, shall be treated as gain from the sale or exchange of property.

(B) DISTRIBUTIONS OUT OF INCREASE IN VALUE ACCRUED BEFORE MARCH 1, 1913.—That portion of the distribution which is not a dividend, to the extent that it exceeds the adjusted basis of the stock and to the extent that it is out of increase in value accrued before March 1, 1913, shall be exempt from tax.

(d) BASIS.—The basis of property received in a distribution to which subsection (a) applies shall be—

(1) NONCORPORATE DISTRIBUTEES.—If the shareholder is not a corporation, the fair market value of such property.

(2) CORPORATE DISTRIBUTEES.—If the shareholder is a corporation, unless subparagraph (3) applies, whichever of the following is the lesser:

(A) the fair market value of such property; or

(B) the adjusted basis (in the hands of the distributing corporation immediately before the distribution) of such property, increased in the amount of gain to the distributing corporation which is recognized under section (b), (c), or (d) of section 311, under section 341(f), or under section 617(d)(1), 1245(a), 1250(a), 1251(c), 1252(a), or 1254(a).

• • • •

Sec. 312. Effect on Earnings and Profits.

(a) GENERAL RULE.—Except as otherwise provided in this section, on the distribution of property by a corporation with respect to its stock, the earnings and profits of the corporation (to the extent thereof) shall be decreased by the sum of—

(1) the amount of money,

(2) the principal amount of the obligations of such corporation, and

(3) the adjusted basis of the other property,

so distributed.

• • • •

Sec. 316. Dividend Defined.

(a) GENERAL RULE.—For the purposes of this subtitle, the term "dividend" means any distribution of property made by a corporation to its shareholders—

(1) out of its earnings and profits accumulated after February 28, 1913, or

(2) out of its earnings and profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made.

Except as otherwise provided in this subtitle, every distribution is made out of earnings and profits to the extent thereof, and from the most recently accumulated earnings and profits. To the extent that any distribution is, under any provision of this subchapter, treated as a distribution of property to which section 301 applies, such distribution shall be treated as a distribution of property for purposes of this subsection.

(b) SPECIAL RULES.—

• • • •

(2) DISTRIBUTIONS BY PERSONAL HOLDING COMPANIES.—

(A) In the case of a corporation which—

(i) under the law applicable to the taxable year in which the distribution is made, is a personal holding company (as defined in section 542), or

(ii) for the taxable year in respect of which the distribution is made under section 563(b) (relating to dividends paid after the close of the taxable year), or section 547 (relating to deficiency dividends), or the corresponding provisions of prior law, is a personal holding company under the law applicable to such taxable year,

the term "dividend" also means any distribution of property (whether or not a dividend as defined in subsection (a)) made by the corporation to its shareholders, to the extent of its undistributed personal holding company income (determined under section 545 without regard to distributions under this paragraph) for such year.

• • • •